

Company Flash

11 January 2007 | 8 pages

Infosys Technologies (INFY.BO)

Another good quarter normalizing for currency

- Another quarter of 10%+ qoq growth** — Infosys had their third consecutive quarter of double digit \$ term growth with revenues growing by 10.1% qoq – as against our expectation of 9%. In rupee terms, revenue growth was 5.9% qoq.
- Pricing uptick!!** — Offshore pricing improved 1.7% sequentially while onsite pricing improved 1.9% sequentially (partially on back of service mix change) – this, in our opinion, is the biggest positive. In the first 9 months, Infosys' pricing has improved ~3.5% for onsite and ~2% for offshore.
- EBITDA margins surprise positively** — Despite the impact of rupee appreciation (3.8% qoq), EBITDA margins improved ~60bp qoq, which is better than our expectation. Improvement in pricing, increase in offshore (+40bps qoq), lower SG&A (-50bp qoq) and high product revenue.
- BPO and products lead the way** — BPO witnessed another strong quarter with revenues growing 19.6% qoq while product business grew 28% qoq. Testing witnessed a growth of 13% sequentially while package implementation witnessed a 16% growth sequentially.
- Weak guidance?** — Fourth quarter guidance implies 4.9% growth (\$ terms) and 3.9% (Rs terms) and EPS growth of 1.3% qoq. The guidance is at Rs. 44.11/\$. FY07 EPS (basic) guidance has been upgraded by ~1% to Rs. 66.63.
- Reiterate Buy** — Infosys trades at 25.7x FY08E and continues to report industry leading growth rates. We reiterate our Buy/Low Risk on the stock.

Buy/Low Risk	1L
Price (10 Jan 07)	Rs2,168.75
Target price	Rs2,340.00
Expected share price return	7.9%
Expected dividend yield	0.6%
Expected total return	8.4%
Market Cap	Rs1,205,359M US\$27,117M

Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2005A	18,917	34.36	48.5	63.1	22.4	44.6	0.4
2006A	24,599	43.82	27.5	49.5	17.1	40.4	1.0
2007E	37,746	66.53	51.8	32.6	11.7	43.8	0.6
2008E	47,841	84.26	26.6	25.7	8.5	39.1	0.7
2009E	59,399	104.62	24.2	20.7	6.3	35.6	0.8

Source: Powered by dataCentral

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Figure 1. Key Financials

	3Q06	2Q07	3Q07	QoQ	YoY
Revenue (US\$ m)	524	746	821	10.1%	56.7%
Revenue	25,320	34,510	36,550	5.9%	44.4%
Cost of revenue	13,270	18,330	19,380	5.7%	46.0%
Gross profit	12,050	16,180	17,170	6.1%	42.5%
Gross margin	47.6%	46.9%	47.0%	9bp	-61bp
Operating expenses	3,440	5,090	5,210	2.4%	51.5%
EBITDA	8,610	11,090	11,960	7.8%	38.9%
EBITDA margin	34.0%	32.1%	32.7%	59bp	-128bp
Depreciation and amortization	1,170	1,220	1,410	15.6%	20.5%
EBIT	7,440	9,870	10,550	6.9%	41.8%
EBIT margin	29.4%	28.6%	28.9%	26bp	-52bp
Other income	440	660	590	-10.6%	34.1%
Profit before tax	7,390	10,530	11,140	5.8%	50.7%
Income tax expense	830	1,230	1,300	5.7%	56.6%
Income from operations	6,560	9,300	9,840	5.8%	50.0%
Affiliates/Minority	-70	-10	-10	0.0%	-85.7%
Net income - recurring	6,490	9,290	9,830	5.8%	51.5%
EO income/(loss)	0	0	0	n.a.	n.a.
Net profit	6,490	9,290	9,830	5.8%	51.5%
EPS - basic	11.85	16.75	17.65	5.4%	48.9%
EPS - fully diluted	11.52	16.36	17.25	5.4%	49.7%

Source: Company Reports

Figure 2. Infosys Annual guidance and revision

Infosys	Revised Guidance		Implied growth		Revision	
	Lower	Upper	Lower	Upper	Lower	Upper
FY07 guidance						
Revenue (Rs m)	139,100	139,190	46.1%	46.2%	0.4%	0.1%
Revenue (\$ m)	3,090	3,090	43.6%	43.6%	2.0%	1.6%
EPS (Rs)	66.63	66.63	48.0%	48.0%	1.0%	1.0%
INR/USD assumption		44.11		-		-3.3%

Source: Company Reports

Figure 3. Infosys 4Q07 guidance

Infosys	Guidance		Implied growth	
	Lower	Upper	Lower	Upper
4Q07 guidance				
Revenue (Rs m)	37,890	37,980	3.7%	3.9%
Revenue (\$ m)	859	861	4.6%	4.9%
EPS (Rs)	17.88	17.88	1.3%	1.3%

Source: Company Reports

Figure 4. Key HR Matrices

	1Q06	2Q06	3Q06	4Q06	1Q07	2Q07	3Q07
IT and BPO professionals	37,146	43,441	46,484	49,495	54,606	61,966	65,293
- Billable	34,611	38,541	39,494	42,604	48,438	53,873	58,073
- Banking Business Unit	1,328	1,351	1,677	1,863	1,817	1,809	1,967
- Trainees	1,207	3,549	5,313	5,028	4,351	6,284	5,253
Sales & support	2,660	2,755	2,938	3,220	3,803	4,184	4,039
Total employees	39,806	46,196	49,422	52,715	58,409	66,150	69,332
Gross addition	4,537	8,026	5,135	5,170	8,097	10,795	6,062
Net addition	3,056	6,390	3,226	3,293	5,694	7,741	3,282
Attrition % (TTM) - Infosys stand alone	9.8%	10.0%	10.0%	11.2%	11.9%	12.9%	13.5%
Utilization							
- including trainees	74.1%	72.9%	70.0%	69.7%	71.1%	67.5%	67.5%
- excluding trainees	77.5%	79.1%	78.7%	77.0%	76.1%	77.5%	75.8%

Source: Company Reports

Figure 5. Execution Matrices – Infosys Consolidated

	1Q06	2Q06	3Q06	4Q06	1Q07	2Q07	3Q07
Billed effort (person-months)	80,471	88,820	95,794	102,154	109,818	121,845	133,711
- Onsite	21,165	23,486	24,918	26,693	30,051	33,346	35,368
- Offshore	59,306	65,334	70,876	75,461	79,767	88,499	98,343
Billed effort distribution (%)							
- Onsite	26.3%	26.4%	26.0%	26.1%	27.4%	27.4%	26.5%
- Offshore	73.7%	73.6%	74.0%	73.9%	72.6%	72.6%	73.5%
Revenue distribution (%)							
- Onsite	47.9%	48.8%	48.6%	49.3%	50.5%	50.3%	49.2%
- Offshore	52.1%	51.2%	51.4%	50.7%	49.5%	49.7%	50.8%

Source: Company Reports

Figure 6. Execution Matrices – Consolidated IT Services

	1Q06	2Q06	3Q06	4Q06	1Q07	2Q07	3Q07
Billed effort distribution (person-months)	66,905	73,776	78,409	83,164	90,198	100,292	107,679
- Onsite	20,997	23,311	24,815	26,551	29,861	33,146	35,175
- Offshore	45,908	50,465	53,594	56,613	60,337	67,146	72,504
Billed effort distribution (%)							
- Onsite	31.4%	31.6%	31.6%	31.9%	33.1%	33.0%	32.7%
- Offshore	68.6%	68.4%	68.4%	68.1%	66.9%	67.0%	67.3%
Revenue distribution (%)							
- Onsite	52.0%	52.4%	52.4%	52.8%	52.5%	54.4%	54.4%
- Offshore	48.0%	47.6%	47.6%	47.2%	47.5%	45.6%	45.6%

Source: Company Reports

Figure 7. Revenue Mix - Geographic Distribution

	1Q06	2Q06	3Q06	4Q06	1Q07	2Q07	3Q07
North America	63.6%	65.4%	65.0%	65.0%	64.0%	63.7%	63.2%
Europe	23.9%	23.7%	24.9%	25.5%	26.2%	25.8%	26.8%
India	2.4%	1.5%	1.4%	1.8%	1.4%	1.6%	1.8%
RoW	10.1%	9.4%	8.7%	7.7%	8.4%	8.9%	8.2%
Total	100%	100%	100%	100%	100%	100%	100%

Source: Company Reports

Figure 8. Revenue Mix – Service Line Distribution

	1Q06	2Q06	3Q06	4Q06	1Q07	2Q07	3Q07
Development	19.4%	19.9%	21.1%	20.1%	21.3%	21.4%	20.1%
Maintenance	30.4%	30.1%	29.5%	30.8%	29.9%	29.2%	29.8%
Re-engineering	5.1%	4.7%	5.0%	4.3%	2.6%	2.3%	2.1%
Package implementation	15.2%	15.8%	16.3%	17.1%	16.5%	17.0%	17.9%
Consulting	4.2%	3.8%	3.1%	3.2%	3.0%	3.6%	3.3%
Testing	6.5%	6.2%	5.5%	5.6%	6.2%	6.8%	7.0%
Engineering services	1.8%	1.9%	1.9%	1.9%	1.8%	1.6%	1.5%
Business process management	3.8%	3.9%	4.0%	4.0%	4.2%	4.5%	4.9%
Other services	9.0%	10.1%	9.8%	9.8%	10.8%	9.9%	9.1%
Total services	95.4%	96.4%	96.2%	96.8%	96.3%	96.3%	95.7%
Products	4.7%	3.6%	3.8%	3.2%	3.7%	3.7%	4.3%
Total	100%	100%	100%	100%	100%	100%	100%

Source: Company Reports

Figure 9. Revenue Mix – Vertical Distribution

	1Q06	2Q06	3Q06	4Q06	1Q07	2Q07	3Q07
Insurance	8.4%	7.9%	7.0%	6.8%	7.0%	6.7%	7.6%
Banking & FS	27.9%	27.8%	29.0%	29.2%	29.4%	30.7%	31.0%
Manufacturing	13.3%	13.5%	14.1%	14.5%	14.5%	14.0%	12.8%
Retail	9.6%	10.5%	10.3%	10.2%	9.7%	9.0%	10.5%
Telecom	17.2%	16.7%	15.8%	16.3%	17.7%	18.9%	18.3%
Energy & Utilities	3.7%	4.3%	5.3%	5.3%	5.4%	5.6%	5.4%
Transportation & Logistics	7.0%	5.6%	4.5%	3.6%	3.3%	2.7%	2.0%
Services	9.4%	9.9%	9.8%	9.6%	8.7%	7.7%	8.3%
Others	3.5%	3.8%	4.2%	4.5%	4.3%	4.7%	4.1%
Total	100%	100%	100%	100%	100%	100%	100%

Source: Company Reports

Figure 10. Client Relationships

	1Q06	2Q06	3Q06	4Q06	1Q07	2Q07	3Q07
Active Clients	443	450	454	460	469	476	488
Added during the quarter	36	34	36	38	38	45	43
No. of million dollar clients	172	191	206	221	221	232	256
No. of 5mn+ dollar clients	73	76	78	81	94	97	108
No. of 10mn+ dollar clients	43	48	51	54	56	61	67
No. of 20mn+ dollar clients	22	23	25	26	28	29	35
No. of 30mn+ dollar clients	14	16	18	19	19	20	22
No. of 40mn+ dollar clients	8	11	14	14	15	16	17
No. of 50mn+ dollar clients	5	6	7	9	11	12	11
No. of 70mn+ dollar clients	3	2	2	4	3	6	8
No. of 90mn+ dollar clients	1	1	1	1	2	3	2
Revenue - top client	5.2%	4.4%	4.5%	4.7%	5.8%	6.6%	6.9%
Revenue - top 5 client	19.1%	17.8%	17.6%	18.6%	19.5%	21.0%	18.9%
Revenue - top 10 client	31.8%	30.6%	29.9%	31.0%	31.7%	32.9%	31.0%
Repeat Business	98.7%	96.5%	93.2%	92.1%	97.0%	95.2%	94.7%
DSO - TTM (in days)	59	59	57	62	65	65	63

Source: Company Reports

Infosys Technologies

Company description

Infosys is the second-largest IT services company in India with more than 66,000 professionals. It is also among the fastest-growing IT services organization in the world and a leader in the offshore services space. Infosys provides business consulting, application development and maintenance and engineering services to more than 475 active clients across verticals such as Banking, Financial Services, Insurance, Retail, Manufacturing, and Utilities in the Americas, Europe and Asia Pacific. Infosys also sells a core banking application - Finacle - that is used by leading banks in India, the Middle East, Africa and Europe. Its subsidiary, Infosys BPO (formerly Progeon), which employs close to 10,000 people, is a provider of BPO services. It launched a subsidiary in April 2004, Infosys Consulting, which provides high-end IT consulting services.

Investment thesis

We rate Infosys as Buy/Low Risk (1L). We are positive on the stock from a fundamental 12-month view. Offshore IT outsourcing has now become a mainstream option, and we think scale and scalability, along with an ability to move up the value chain, are key criteria for successful offshore IT vendors. In this respect, Infosys appears well positioned and continues to gain given its strong branding and industry-leading sales force. We like companies such as Infosys that should see above-industry average volume growth along with some modest pricing improvement. We expect Infosys to deliver a revenue CAGR of 33.8% and EPS CAGR of 32.8% for FY06-09. Unlike many other high-growth firms in other industries, Infosys continues to generate solid FCF, and its RoE of 40%+ continues to be well above its cost of capital.

Valuation

Our target price of Rs2,340 is based on an FY08E P/E of 28x given our forecast of 32% earnings growth and upside potential from pricing improvement. The 28x multiple was also derived from a P/E band analysis of Infosys's trading pattern. During slowdowns in tech and offshore IT services, Infosys has traded at an average one-year rolling P/E of 25.1x with a low of 13x. Retrospectively, the average trading multiple of 25.1x is much lower because Infosys's earnings have consistently seen consensus upgrades on greater visibility and revisions in management guidance. At this stage of the growth cycle, we believe Infosys should trade in a band of 25-30x 12-month forward given the strong outlook for offshore IT services. Infosys has historically grown faster than the broader market (BSE Sensex) and traded at a premium of 40-135% (average of 84%) to the market. Our estimates continue to assume a P/E premium of 80% to the market; this is justified, in our view, given the strong FCF, ROIC and growth rates for Infosys vs. the overall market. We believe P/E remains the most appropriate valuation measure given Infosys's profitable track record and high earnings visibility.

Risk

We rate Infosys as Low Risk, which is consistent with our quantitative risk-rating system that tracks historical share price volatility. The key downside risks to our target price include (1) any significant appreciation of the rupee against the US dollar/euro/pound; (2) pressure on billing rates (as Infosys continues to enjoy a 10-15% premium in its billing rates); (3) a sharp slowdown in the US economy; and (4) limited H1B visa quotas.

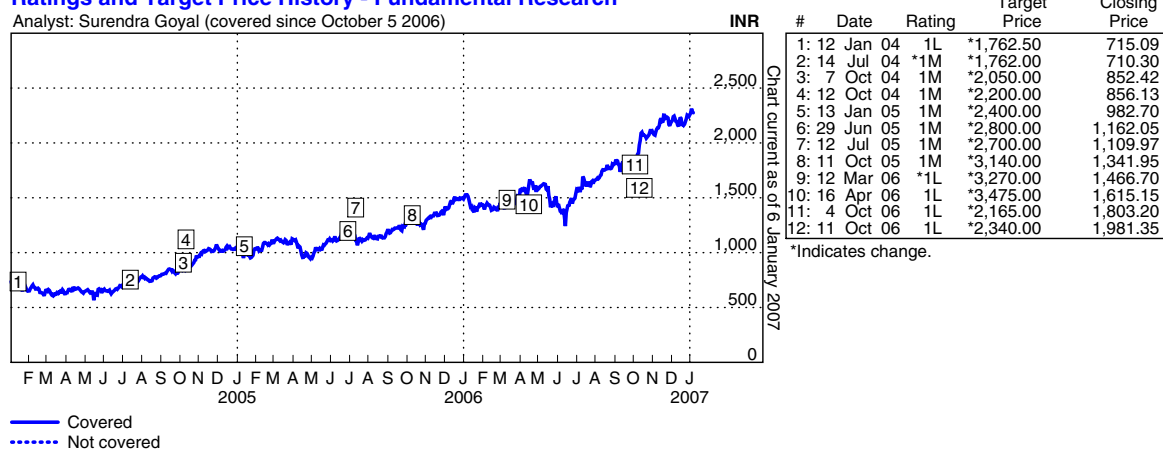
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Analyst: Surendra Goyal (covered since October 5 2006)



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